NATIONAL OFFICE
250C - 2nd Avenue S.
Saskatoon, Sask., S7K 2M1
Fax (306) 664-6226
Tel (306) 652-9465

national farmers union

In Union is Strength

National Farmers Union

Submission

to the

Task Force on National Dairy Policy

presented in

Saskatoon, Sask. November 20, 1990

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INTRODUCTION:

We welcome this opportunity to present our views on the future of our national dairy policy.

The opening paragraph of the consultative document states the federal review of dairy policy is part of an overall review of agricultural policy "to try to improve the sustainability of the industry and make it more market responsive and self-reliant in the face of challenges posed by trade imperatives, and social and economic needs."

Code words such as "sustainability", "market responsive" and "self-reliant" are the source of apprehension among many producers.

"Sustainability implies that farmers will face greater difficulty in being able to survive in future unless they are able to adjust to the changing demands dictated by the market (such as accepting lower product prices) or survive on lower margins of return as tariffs, import quotas and subsidies are eliminated. This would in turn force them to become more "self-reliant" for economic survival upon the market economy.

The primary demand upon dairy producers to become more "market responsive" is, in our view, based on the desire of industry to acquire raw product at lower prices and in such volumes as it may demand. The yardstick for setting such prices would be the availability of competitive sources of supply-whether produced domestically or imported. This "new approach" in farm policy will not improve farm stability and national self-

sufficiency but lead inevitably back to the jungle where only the strongest and most powerful can survive.

It is conceded in the consultative document that the past 20 years of operation of the supply-management system has been successful in:

a) reducing producer and processor risk;
b) providing increased stability;
c) providing market security; and
d) responding to changing requirements.

It is further noted that in 1988-89, there were approximately 36,500 dairy farms in Canada compared with 153,000 in 1968-69. Fewer than 1 in 4 have survived. The number of cows per herd has almost doubled since 1973-74 and production per cow has almost doubled over the past quarter century.

The "system", therefore, does not seem to have protected the status quo. Efficiency has not been stifled. The obvious question on the minds of many producers is: "If it isn't broken - why fix it?"

A RETURN TO DEREGULATION?

Few producers who have knowledge of the dairy industry prior to the formation of the Canadian Dairy Commission and implementation of Market Share Quotas after 1970 would opt to return industrial milk production to the deregulated state of the 1950's and mid-60's.

Current dairy policy was necessitated in part by our sharp loss in export markets following formation of the European Economic Community as well as encountering a very protectionist U.S. market. The structuring of an administered pricing and supply-managed dairy policy was an act of self-preservation for the industry.

The fact that this policy has succeeded is a matter of

record. Stability and security followed. Canadian producers did not contribute to massive build-ups of chaotic world surpluses in dairy products that were evident until recent years. The supply-managed controls imposed upon Canadian producers have been directed toward meeting our domestic milk requirements. The decision of any nation to restrict production of a product, such as milk, to meet only domestic needs must be regarded as an inalienable right of sovereignty over domestic policy issues. To additionally regulate the selective and quantitative importation of related products is also equally its right. Supply management simply cannot function or survive without regulation.

Canada is nonetheless confronted with challenges to its sovereignty that have resulted from entering into an ill-conceived trade agreement with the United States. Furthermore, we face the uncertainty of future trade rules under the GATT pertaining specifically to Article X1 and its relevance in protecting supply-managed programs. It has become apparent that it is less than perfect in providing such protection.

The U.S. recently lodged and won an intervention before a GATT Panel pertaining to our right to impose import controls over ice-cream and yogurt. Article X1 failed us. To be able to strengthen Article X1:2(c)(i) in the current round of GATT negotiations remains an unresolved objective. It is by no means certain at the time of writing that the desired strengthening of this section will come.

The concept of subsidies, including our current direct payment of $6.03 per hl on industrial milk is also under attack at the GATT negotiations.

Development by GATT negotiators of the Aggregate Measure of Support (AMS) to gauge the relative values of various farm assistance programs on a specific commodity basis also has potentially serious implications for our dairy policy.

A further possible conversion of AMS to "tariffication" equivalence represents an alternate means of destroying the basic

pillars of supply-management programs. The inevitable result would be to lower farm gate prices and loosen production controls. The cumulative impact of such a scenario leading toward "market responsive" deregulation would be crippling to the family farm dairy industry and our concepts of self-sufficiency.

THE ISSUES:

The Task Force has requested opinions on a number of issues related to its policy review. These are as follows:

Supply Management - As our earlier comments will attest, we believe it is absolutely essential to retain an administered price-regulated national supply management system. Imports of foreign products must be effectively controlled through licensing and import quotas if dairy farmers are to survive.

The discussion document concedes that "... international marketing has been used by Canada, as it has by most other countries, more as a means to dispose of surplus than as a business opportunity." This being the reality, import licensing is absolutely essential if Canada is not to become a dumping ground for surplus dairy products.

It is stated that "supply management interferes with market mechanisms and concerns have been expressed with some of the effects of using it as a policy instrument.

The issue is really one of power. Those who are concered about supply management would really prefer dairy farmers to again assume their traditional roles as price takers. The use of the most efficient 70% of producers to calculate costs of production formulas has been criticized as not forming the basis of a high enough level of efficiency. When one considers the level of attrition that has taken place in the number of dairy farmers referred to earlier, the opposite might be argued.

Relating to the question about the validity of includ-

ing administered pricing as a fundamental component of supply management, it is an issue worthy of examination.

The discussion document notes that: "Some people argue that only restrictions on the supply of domestic production and import controls are essential to the operation of the system."

This concept is more important for what it <u>does not</u> say than for what it says. In such a scenario the issue of pricing would obviously transfer greater power to the processing sector. It might eliminate the cost-of-production price formula setting mechanism now in use. It could provide the federal government a pretext to discontinue the payment of dairy subsidies since it has repeatedly voiced its objective to eliminate subsidies.

The distribution of available supply would also be determined by competitive market forces. It is conceivable that processors would scramble to contract with individual producers for milk supplies. There would be discrimination in pricing, with producers of lower volume or living a further distance from processors being less preferred. There would be duplication and hence, increased costs in the transportation gathering system. There would inevitably be fewer processors as the struggle to consolidate and gain local market and regional monopoly status would intensify.

Such a restructuring of the supply management system would meld very well into the Canada-U.S. Trade Agreement (CUSTA) agenda to achieve the "level playing field" now being sought so ardently by the industrial sector. <u>But it would only lead down a path toward lower prices, lower farm income and fewer dairy farmers</u>.

Thus, while supply might be managed and imports controlled to avoid the accumulation of surpluses or the possibility of encountering supply shortages, a primary stabilizing objective built into our current supply management program, namely to provide producers with prices based on cost of produc-

tion - would be lost.

We reject as inadequate any future supply management program that limits its function to restricting domestic supply and regulating import controls. We strongly recommend that such an option not be included among those this Task Force may propose to the Minister.

Market Responsiveness - In our view the current supply management system is in many respects quite compatible to the concepts of market responsiveness. We have, for example, a consistent supply of high quality milk that is assured because the "boon and bust" experiences encountered by farmers in earlier years have been eliminated.

The so-called "changing requirements and opportunities which occur in the marketplace" must, in the first instance, be recognized by the industry sector through interpreting potential consumer demand for particular products. Once the need is identified for additional production, we have no doubt that the capacity to produce more milk can be accomplished.

On the other hand, as the discussion paper notes, critics have complained that the industry has not shown itself to be responsive to shifts in consumer demand. The issue of providing limitless low-fat products probably does have limits when such products have the potential to build up surpluses of butterfat, for example, which would create a different kind of problem.

We recognize such problems can and do exist but as is well known, milk is currently priced to the farmer on the basis of its butterfat content. The concept of Multiple Component Pricing has received some study and consideration. We support a shift to such a grading philosophy - but farmers are not likely to reduce emphasis on butterfat production unless their economic benefits in doing so can be justified. The objective of MCP must not be approached from the position of using it as a mechanism to lower producer returns.

The opinion of some stakeholders that one restraint to market responsiveness may be "the often strained relations between producers and processors and the lack of openness in decision-making affecting consumers." In our view, if there is a source of strained relationships between producers and processors, it may be generated by the continuing desire of the processing sector to acquire cheaper milk as a first condition in meeting consumer demands for new or innovative products. Certainly operating as they do within an administered price structure, the bottom line for processors in marketing new products is profit. We do not object to profit - but we draw the line at their profiting if it necessitates farmers producing milk at a loss.

Pricing - The discussion document raises the question of the need for a "more competitive basis for determination of prices."

From the perspective of current federal policy directions developing a more competitive basis for determination of prices points only in the direction of finding a way to lower producer returns. We do not accept that there is a "need" to do so.

The example of pricing negotiated between producers and processors in Canada's poultry industry every two to four weeks at provincial meetings may be satisfactory for chickens - but milk is different. Chicken is a product competitive with other kinds of meat such as beef and pork which has no supply management constraints and is priced on the open market. Consequently, chicken prices are much more sensitive to market forces than is milk which has no comparable substitutes. Consequently, we believe the cost-of-production approach used for milk remains a superior system of price determination.

While some consumers may compare milk prices in Canada to that of other industrial countries, such comparisons should not be accepted without regard to relative production costs. Canadian milk prices are most often compared to those in the

U.S., however, this is always done without regard to comparable levels of taxes, energy costs, equipment costs, housing costs and so forth. We continue to believe that given Canadian weather conditions and other economic factors, Canadian consumers are well served.

With respect to the "appropriate authorities" to determine valid costs of production, it should not perhaps be a choice between "independent authorities or producer marketing boards." Rather, it is a situation where appropriate authorities would need to be persons competent in determining cost of production. If they are at arm's length from the industry, they will nonetheless need at some point to convince producers that their calculating methods are legitimate and sound. In that respect, we consider the current cost-of-production survey conducted among the top 70% of producers as acceptable.

DIRECT PAYMENT TO FARMERS (SUBSIDY):

The present federal direct payment to dairy producers of $6.03 per hl on milk used for domestic consumption has not changed for fifteen years. As noted, it now represents 12.7% of the target price for industrial milk compared to 24% in 1975.

Assuming the average industrial milk target price to be $47.48 per hl, the removal of the subsidy from producers would result in a sharp drop in income and undoubtedly force many out, particularly new or recent entrants who have purchased quota and may carry relatively high debt obligations. Survivors would likely be comprised in large part of established producers who are relatively debt free. Lowering the target price in increments would have the same ratcheting-down effect on income.

The attrition that would accompany a withdrawal of the subsidy might eventually reduce industrial milk production below domestic consumption requirements. Such a shortfall could be readily made up from imports but not without affecting the existing efficiency of the processing industry. It would, in the short run, drive up their costs and, in turn, increase consumer

prices. The current subsidy is, in fact, price protection for consumers as much as it is a payment to producers. Passing the cost on to consumers could result in decreased demand.

There are those who will argue that producers who remain after elimination of the subsidy would eventually pick up any shortfalls in production. While the potential might be there, the opportunity might not. If the current system should be replaced by one which administers only supply quotas and imports, it might be difficult to cut back on imports once they have been increased to supplement shortfalls in domestic production.

We regard the $6.03/hl subsidy as the lynch-pin to the entire national dairy program. It is the stabilizing factor that sustains production levels as well as keeping them in check from over-production. It is the factor that keeps provinces in the national program. If it was eliminated, some individual provinces would, we believe, be inclined to abandon the discipline imposed by the national Market Share Quota and instead encourage industrial milk production to levels of provincial self-sufficiency.

In its current mind-set to eliminate subsidies, we quite understand the federal desire to phase out the dairy subsidy. However, we respectfully point out that the ripple affect of such an action will go well beyond the resulting loss in producer income.

It would affect our self-sufficiency and undermine the effectiveness of supply management principles. It would displace many more producers and might well lead to the structuring of large factory-type dairy farms. We support continuation of the direct payment approach.

<u>The Regulatory Framework</u> - In our view the regulatory framework of the current dairy policy, although complex, has worked reasonably well. The Canadian Dairy Commission has an enviable record in administering the national program. Political

interference in its operations have appeared to be minimal, considering the interests of the various provincial government, producer and processor interests that have had to be accommodated.

The CDC, as noted, reports to the Minister of Agriculture and also appears annually before the House of Commons Standing Committee on Agriculture. This does not seem to be unreasonable when $275 million of public funding is spent on the national dairy program.

We are, therefore, not as "hung up" on the need to have a mechanism to determine milk prices "truly at arm's length from government and the ministers" as the Minister of Agriculture appears to be.

The only circumstance we can imagine where the government would wish to remove itself to "arm's length" from the decision-making process would be if it had less stake in the policy than it does now. Elimination of the subsidy or removing the CDC from marketing activities would achieve that condition. There is no particular virtue, from the producer perspective, to having the decision-making mechanism more arm's length and transparent than is presently the case if the government intends to remain committed to stabilizing the industry.

On the other hand, we have apprehensions if a Consultative Committee of the CDC should be comprised of private consultants and representatives from various vested interest groups in which producer representatives would have a minority control.

Committees such as this do not exist in other sectors of the economy such as in the petroleum or banking industries, for example, where pricing policies are far less transparent than in agriculture. We disagree that farmers should suffer the kind of potential disadvantages implicit in such an arrangement.

If a more transparent method of decision-making is indeed required, this could be accomplished by authorizing the

CDC to hold annual public hearings to consider the representatives of the various stakeholders. The Commission would be at least as fair and competent in rendering judgements as any private consulting agency conceivably might be.

THE INDUSTRIAL MILK QUOTA SYSTEM:

The NFU has never endorsed the principle of quota values that have nonetheless generally emerged into the dairy industry. Consequently, we oppose any consideration for having quota values included in calculations for Cost of Production formulas or in setting prices.

The overall value of farm product production quotas of Canadian farms reported by Agriculture Canada for 1988 was $6.4 billion. This asset value is essentially a windfall item since all first level entrants into supply-managed production were allocated quotas at zero cost.

Unfortunately, the phasing out of quota values will be difficult. New entrants have in many cases paid dearly for the privilege of production. Lending institutions, too, have accepted quotas as loan collateral and now hold a vested interest in maintaining their value.

Since quota values are not a consideration in the price-setting mechanism, consumers have not been prejudiced by their existence. They may, however, contribute toward narrowing margins of return in some instances.

While the current system of quota transfer through an exchange system may be considered efficient, it is prejudicial to the interests of new entrants or smaller producers who wish to expand. Quota value would drop sharply if the price-setting role of the supply management system was eliminated together with the existing $6.03/hl subsidy. We believe that would be a worse evil than the existing situation.

The concept of a "transfer assessment" placed on quotas

offered for sale is a fair and workable mechanism to provide for new entrants and other programs. The levels of such assessments might be proportionately higher for producers who were originally vested with free quota than for producers who in past purchased all or part of their quotas.

<u>INTERPROVINCIAL MOVEMENT OF QUOTA</u>:

The discussion document notes that the issue of interprovincial movement of quota has been difficult to resolve.

It is apparent the allocation of additional quota to provinces would be most easily accomplished through an increase in domestic consumption. This could result from the development of social programs in the provinces, such as school milk programs. Supplemental contributions of milk and cheese could also be made to the increasing number of food banks that have emerged in every province.

In the meanwhile, it would appear that the transfer of quota interprovincially will be extremely limited. Such considerations as establishing new entrants and measuring the impact upon processing facilities would need to be taken into account.

The alternative - emasculating the supply management program as it now exists - would be intolerable to producers.

<u>TRADE ISSUES</u>:

In our view, if the existing supply management system is to survive, tight controls over the importation of dairy products will need to continue.

Producers have already been paying a high cost to export dairy products such as skim milk powder and butter which have been in surplus. In some measure such surpluses have accumulated as the result of imports of other dairy products, notably cheese.

It is clear that much rides on the more precise clarification of Article X1 of the GATT in shaping the future direction of our industry.

The allocation of import quotas to importers with a record of imports before the imposition of quotas is discriminatory to potentially new importers, however, this issue should not be used as a pretext to increase import quotas.

Such might be the situation if Supplementary Import Quotas are used for dairy products. No such quotas are justified as long as milk production in Canada is in surplus capacity or has the capability to increase. Any increase in imports is bound to have a negative impact on the industry unless an offsetting volume in exports occurs. An importer might, therefore, negotiate an exchange in product with another country as a condition for being granted a S.I.Q.

The primary apparent condition to Canada expanding international markets would begin with processors being able to acquire raw product at the lowest possible price. This has clearly emerged as the key demand of the processing sector for all farm products under supply management.

We submit that if this can only be accomplished at the expense of farmers, the efforts to increase our international markets in dairy products may not be worth it.

FURTHER PROCESSOR ISSUES:

The issues facing processors primarily revolve around their desire to acquire cheap milk to satisfy their particular economic needs. This would likely be achieved at producer expense.

These problems are a direct spin-off of the CUSTA, the lowering of tariffs that is now occurring, and the easier market access that may result from the GATT negotiations.

It is a combination of these various factors that is contributing toward producer apprehensions about their future in the dairy industry.

We strongly urge that this Task Force not recommend options to the Minister of Agriculture that will undermine the stability that exists in the present National Dairy Policy.

This system has provided stability of supply and price to processors as well as to the consuming public. Dairy producers are providing a valuable resource and service to the nation that, we regret to say, is often overlooked in the current preoccupation of government in pursuing a cheap food policy and restructuring the economics of the industry by transferring wealth from farmers to commercial enterprises.

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All of Which is Respectfully
Submitted by:

NATIONAL FARMERS UNION